



Western Independent Bankers

Annual Conference for Bank  
Presidents, Senior Officers &  
Directors

# *The Changing Landscape of the M&A Environment*

## "An Accountants Perspective"

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# “An Accountants Perspective”

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FASB, SEC, IRS and various regulatory agencies have all been very active in recent years. For example:

- Required adoption in 2007
  - Pensions and postretirement plans (FAS 158)
  - Uncertain tax positions (FIN 48)
  - Interagency policy statement on the ALLL (2006)

# “An Accountants Perspective”

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- Ready to go in 2008
  - Fair value measurement (FAS 157)
  - Fair value option (FAS 159)
  - Split dollar arrangements – BOLI (EITF 06-4)
  - Private letter ruling, dated January 25, 2008, requires reconsideration of tax positions on executive compensation
  
- Looking forward to 2009
  - Business combinations (141(R))
  - Consolidated financials statements (FAS 160)

# “An Accountants Perspective”

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Albeit only a partial overview, these examples of new standards and regulations truly possess the potential to impact both the structure and value of future M&A transactions.

# FAS 141(R) - Business Combinations

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- Effective for annual periods beginning after December 15, 2008
  - Will not allow for early adoption
- Key objectives: improve certain purchase accounting rules by increasing –
  - Transparency of business combinations to users of financial statements
  - Consistency with the conceptual framework
  - Move closer to the fair value model

# FAS 141(R) - Business Combinations

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- Fundamental principle . . . the acquired business should be recorded at fair value
  - Focus on entire business at fair value without cost incurred by the acquirer
  - Best evidence of fair value is fair value of “all” consideration transferred
  - Definition of fair value is FAS 157
  - Fair value provisions will require the development of complex valuation techniques
  - Transactions will require fair value assessment and purchase price allocation

# FAS 141(R) - Business Combinations

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## ➤ Impacts to companies

- Requires more complex valuation techniques
- Fair value estimates at both the date the deal closes and post-deal
- Introduces unpredictability in estimating the ultimate purchase price
- Greater volatility in earnings
- Reduces ability to predict the accretion / dilution resulting from the transaction
- Unpredictability of the effect on ratio and performance measures

# FAS 141(R) - Business Combinations

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## ➤ New definition of a business

- A business is an integrated set of activities and assets that are capable of being conducted and managed for the purpose of providing either
  - A return to investors
  - Dividends, lower costs or other economic benefits
- Removes “self-sustaining” requirement
- Assess from the perspective of a hypothetical buyer

# FAS 141(R) - Business Combinations

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## ➤ Significant changes

- Measurement date
  - Currently measure publicly traded equities on announcement date and assets and liabilities at effective date
  - New standard requires all consideration to be measured on the date when control is obtained
- Deal implications
  - Deal price will have time to reflect market reaction
  - Creates uncertainty in estimating acquisition price

# FAS 141(R) - Business Combinations

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## ➤ Significant changes

- Measurement period
  - Currently there is a one year allocation period
  - New standard requires provisional accrual of estimated amounts not known at effective date
    - Changes in provisional account disclosed each quarter
- Deal implications
  - Will need to plan ahead to make estimates rather than using a rule of thumb

# FAS 141(R) - Business Combinations

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## ➤ Significant changes

- Transaction costs and restructuring charges
  - Transaction costs and restructuring charges are currently capitalized in goodwill or recorded as a liability
  - New standard requires recognition as period costs
- Deal implications
  - Income statement volatility
    - How will these expenses be disclosed prior to deals being announced?
  - Decrease in goodwill

# FAS 141(R) - Business Combinations

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## ➤ Significant changes

- Fair value of loans
  - Current standard carries over the ALLL to the acquirer
  - New standard eliminates the ALLL and loans are individually recorded at fair value taking inherent credit risk into consideration
- Deal implications
  - Additional provision required for subsequent identification of credit risk
  - Accounting and disclosure issues

# FAS 141(R) - Business Combinations

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## ➤ Significant changes

- Bargain purchase requires that the entire excess of fair value of net assets over purchase consideration be recorded as an extraordinary gain
  - Extraordinary gain recorded only after a reassessment of the purchase price allocation
  - Reduction of assets is inconsistent with model to record assets at fair value
- Deal implications
  - More scrutiny on valuations in a bargain purchase . . . great companies rarely trade at bargain basement prices!

# Where the Deal Points are Buried!

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- Failure to thoroughly understand the proposed transaction, to include the pricing model
- Understanding how to minimize pricing risk through the use of “caps and collars”
- Valuation allowances that are understated or don’t adequately reflect inherent risk
- Settlement of stock award programs and severance agreements and their potential impact on pricing

## Where the Deal Points are Buried!

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- Recent enhancements to benefit plans, especially in the BOLI and death benefit arena . . . in contemplation of the deal
- Unexpected costs associated with the termination of “other” agreements and contracts

### *In Summary . . .*

Conceptual framework for structuring M&A transactions in future will give consideration to “all” assets and liabilities, and embrace fair value measurement principles as required by FAS 141(R).